

Serious ICOs – Overview of Swiss legal requirements. Lessons learned.

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Thomas Hua

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“Just because you call something a blockchain or an ICO, that doesn’t mean you aren’t subject to normal law”

Juan Benet

(Founder of Protocol Labs)

FINMA

- **Who:** Swiss financial market supervisory authority
- **Purpose:** Strengthen the reputation and competitiveness of the Swiss financial center through:
 - (general) protection of creditors and clients ; and
 - protection of market functioning.
- **General stance:** removal of unnecessary regulatory obstacles to innovative business models.
 - Principle-based, technology-neutral and competition-neutral regulation and supervision.
 - No “ICO-law”.
- **Further legislative changes ?** Report of the blockchain and ICO working group by end 2018 in response to motion Béglé (17.3818)

Token categories (1)

- **Asset token:** create a claim on their issuer in the form of debt, equity or other (ex: equity give a claim to future profits, debt give a claim on interests, or membership right). Tokens enabling trading of physical assets to be traded on the blockchain are asset tokens (claim to the asset).
- **Payment token:** create no claims on their issuer and intended to be used, now or in the future, as a means of payment for acquiring goods or services or as means of money or value transfer (cryptocurrencies).
- **Utility token:** provides access digitally to an application or service by means of a blockchain-based infrastructure at the point of issue.

Token categories (2)

- **Evolutionary:** The function of a token and its ensuing classification may change over time. Regulatory aspects will apply at each stage.
- **Non-exclusive:** The classification is not mutually exclusive (hybrid tokens). In these cases the requirements are cumulative.
- **Technology-neutral:** Classification is not based on the use of any specific technology or code.
- **Substance over form:** Classification takes into account the effective functions and/or use of the token and does not solely rely on the names given or the intent of its issuer. Technical safeguards may be required to exclude payment/asset token classification.

Securities Law (1)

- **Definition:** Securities are defined as standardized claims, whether certificated (*Wertpapiere*) or not (*Wertrechte*), which are suitable for mass trading (art. 2 let. b FMIA). Mass trading starts when offered to more than 20 clients (art. 2 para. 1 FMIO).
- **Pre-financing:** If tokens in the pre-financing phase confer a claim when issued, they can be qualified as securities.
- **No form requirement:** When creating uncertificated securities, there is no form requirement other than to maintain a ledger containing number and denomination of the securities issued (Art. 973c para. 3 CO) on the blockchain.

Securities Law (2)

- **Not regulated:** Self-issuance and public offering of tokens/coins to third parties without intermediaries are not regulated or subject to authorization.
- **Regulated:** Creation and issuance of derivative products to the public (art. 3 para. 3 SESTO) and the trading of securities (art. 10 SESTA) are regulated.
- **Prospectus requirements:** The issuance of equities or bonds can result in prospectus requirements under the Swiss law (art. 652a and 1156 CO), for which the issuer is liable. The prospectus is mandatory but not subject to FINMA review (under review).

Securities Law (3)

- **Asset tokens:** Considered as uncertificated securities, with the obligation to hold a ledger.
- **Payment tokens:** Under current legislation, not considered as securities (having the same function as money).
- **Utility tokens:** Not considered as securities, provided that (a) the sole purpose is to confer digital access rights to an application or service (i.e. *no investment function* – in practice, not tradable) and (b) the token can be used in this way upon issue (no beta version). Otherwise, qualified as securities as they have an investment function.

Banking Act / Collective Investment Schemes Act



- **Banking Act - Application:** Banking Act will apply if the issuance of tokens is associated with claims for repayment on the ICO organizer (ex: guaranteed capital return). If so, a bank authorization is (theoretically) required.
- **Banking Act - Exceptions:** Funds in exchange of transfer of ownership or for the rendering of a service, bonds or other standardized debt instruments, etc. (art. 5 para. 3 BO).
- **Collective Investment – Application:** Only applicable if funds received from several persons are managed by third parties.

Anti-Money Laundering Act (AML) (1)



- **Application:** Any payment services or issuance of means of payment (art. 2 para. 3 let. B AMLA).
- **Exception:** Two-party relationships, where the issuer of the means of payment is also sole user of the payment system, are not considered means of payment (FINMA guideline 2011/1).
- **AML Obligations:** identification of client and beneficial owner, clarifying economic background, clarifying and recording relationships and transactions with increased risks, organizational measures, and reporting to MROS. Registration with a Self-regulatory organization (SRO) or use the services of a third party financial intermediary subject to AML (encouraged by FINMA).

Anti-Money Laundering Act (AML) (2)



- **Payment tokens:** Payment tokens, which can be transferred on the blockchain, will trigger AML obligations for the issuer (all crypto-crypto and crypto-fiat transactions, if on a commercial basis, or wallet services where service provider manages private key).
- **Utility tokens:** AML not applicable, as sole purpose is to provide access rights to an application or a service.
- Accessory payment service is allowed if (a) main service is unrelated to financial sector; (b) same party performing both main and payment services; (c) payment service is less important than main service; and (d) payment service is necessary to main service (art. 2 para. 2 let. a nr. 3 AMLO).

Summary

- **No functional token (Pre-sale / pre-financing):**
 - Securities regulations (?) and/or Banking Act (?)
 - No AML.
- **Functional token:**
 - **Asset token ICO:**
 - Securities regulations: Ledger and Prospectus (?)
 - No AML
 - **Payment token ICO**
 - AML (SRO or third party financial intermediary)
 - No securities
 - **Utility token ICO**
 - Securities regulations (?): not applicable unless token is non-functional or has other investment function
 - AMLA (?): only if payment service beyond accessory

“When (not if) regulators start looking at ICO deals they might want to investigate, they will likely start with the ones that exhibit weaknesses.”

William Mougayar
(Venture advisor)

Thank you for your attention!

Thomas Hua
Associate
Attorney-at-law,
hua@gbf-legal.ch

gbf
Attorneys-at-law

P.O. Box 1661
Hegibachstrasse 47
8032 Zurich
Switzerland

T +41 43 500 48 50
F +41 43 500 48 60

P.O. Box 1911
Route de Pré-Bois 20
1215 Geneva Airport
Switzerland

T +41 22 533 48 50
F +41 22 533 48 54

contact@gbf-legal.ch
www.gbf-legal.ch